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THE RELATIONSHIP BETWEEN LOANS AND TAXES IN WAR FINANCE

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I shall discuss the relationship between loans and taxes in war finance solely with reference to the present case of the United States. I shall also assume that the people are prepared to adopt that financial policy, however burdensome it may be, which will enable us at the earliest possible moment to place an adequately equipped army in the field and sustain our allies with abundant supplies of food and military material. That this is a well-founded assumption general acquiescence in the selective draft affords convincing evidence. This policy, however strongly advocated by military experts, would hardly have been adopted if the experience of other countries during the present war had not made clear to the ordinary layman that it was the wise course to follow. Similarly, I feel certain that if the people become convinced that a particular method of financing the war—financing it mainly by taxation, for example—would contribute to the speedy and effective mobilization of the economic forces of the country for war purposes, they would adopt that policy in the same spirit which they have manifested toward the conscription of men for military service.

On the other hand, if it makes no particular difference in the conduct of the war whether the bulk of the funds is secured through loans or taxes, if it is a purely financial question, it is altogether unlikely that the people would be ready to meet by taxation a large proportion of the cost of the war. Revenue from taxation during the war, slightly exceeding the amount which will be needed in subsequent years of peace to meet ordinary expenditures and debt charges, would be the policy which almost certainly would be adopted. On purely financial grounds, the amount of taxation during the war should be somewhat greater than in the following years of peace since patriotic fervor lightens the burden upon the taxpayer, and during the continuance of a war business is somewhat more active than during a series of years good and bad in times of

peace. The special profits reaped by those engaged in industries stimulated by war are also a proper field for special taxation of the English excess profits variety.

The equities of the situation as between those who serve with the colors and those who remain at home would justify placing the entire burden of financing a war upon those who remain at home, but this in itself is not a consideration which can be relied upon to develop general willingness to make the sacrifice which the policy of taxation would impose upon the community. But suppose the people become convinced that the amount of taxation levied during the war has an important bearing upon the speed and effectiveness of our preparations for the conflict. Under present arrangements, four billion dollars of our estimated expenditure during the current fiscal year are to be derived from taxation and fifteen billion dollars from loans. It is quite possible that this is a wise proportion, but if it were clear that some other proportion would better serve the purpose in view, is it to be doubted that the people would favor its adoption? The proper, and also the feasible relation between loans and taxes in war finance is surely that proportion which will most speedily bring about the mobilization of our economic forces for the effective prosecution of the war.

Without prejudging the question, and simply as a concrete method of approach, I am going to contrast the situation as it is and may be expected to develop under the financial arrangements which have been authorized, with the situation which might be expected to develop if the proportions between loans and taxes had been reversed, and fifteen billion dollars were to be raised through taxation and only four billion dollars by means of loans.

In one very fundamental respect the two policies would have similar consequences. The expenditure of nineteen billion dollars means at the present level of prices the employment of something like a third of the capital and labor of the country in providing goods and services for the government. There will consequently not be enough labor and capital available to produce the customary quantity of goods and services for civilian consumption and for the usual annual additions to the capital equipment of the country. This radical, and one is tempted to say ruthless, change in the relative proportions between individual and national consumption will also be accompanied by very great changes in the quantities of

the various things to be consumed. Some things will be wanted in much greater quantities, while in the case of others the demand will be greatly reduced. Those engaged in industries, the demand for the products of which is stimulated by the war, will prosper, and labor and capital must be transferred to them from other industries which must necessarily become less than normally active. This transition from a peace to a war basis is necessarily a painful process to many engaged in well-established and prosperous businesses and to their employees. There is a natural inclination to make the change slowly, with the least possible disturbance and loss to those concerned. But what if military exigencies will brook no delay? Clearly this is our present situation. There is urgent need for the production of more food, ships and military material of all sorts. No sacrifice is too great which will accelerate and increase the production of these vitally important commodities. Unhappily, the process of transition from a peace to a war footing is proceeding slowly with consequent danger of increasing the loss of life at the front, the prolongation of the war, and in the last analysis, increasing the money cost of the conflict. Supplies of efficient labor and of material for the war industries are not being enlarged to anything like the maximum possible extent. The fundamental cause of this unsatisfactory situation is not far to seek. It is because the demand for labor and materials continues intense in industries, the products of which are valueless for war purposes.

If the policy of financing the war mainly by means of taxes had been adopted, the civilian demand for the products of all our industries would have been greatly diminished. Owners would have been eager to convert their equipment to war uses, and much labor would have been eager for employment in the war industries. It is the fundamental defect of the loan policy in the present emergency that it exerts a far less effective influence in these directions. The loan policy would be quite as effective if all subscribers to liberty bonds made payment entirely from current income saved while the proceeds of each loan were being expended by the government. In this event the civilian demand for goods and services would decline roughly in proportion to the increased government demand. A large part of the funds secured through war loans does, of course, represent current savings, but a very considerable part consists of borrowings from banks involving the expansion of bank credit.

There is an increase in the total amount of purchasing power with no corresponding increase in the volume of goods offered for sale. The civilian demand for goods is consequently not directly reduced by the full amount of the loans. People endeavor to maintain their accustomed scale of expenditure though it is manifestly impossible. The attempt is frustrated by the rise of prices. The expenditure of a given sum of money procures the proceeds of the employment of smaller and smaller amounts of labor and capital.

The rise of prices which results from the loan policy of war finance is of course particularly burdensome to persons in receipt of stationary incomes and adds greatly to the money costs of a war. But these are minor defects in comparison with the check which it places upon the rapid mobilization of the labor and capital of the country for war. The continued civilian demand only slightly checked by exhortations to economy deludes producers into the belief that business can continue as usual for a long time, if not during the entire course of a great war. They continue to buy materials, retain their labor force by the offer of higher wages, and endeavor, often with entire success, to produce accustomed supplies of goods, regardless of their utility for military purposes. So far as materials are concerned, the government, or those having government contracts, may meet the situation by the offer of higher and higher prices, and where this course is only partially successful, may resort to the commandeering of essential products. As to labor, the offer of higher wages is not a sufficient means of securing an adequate and efficient supply and commandeering is out of the question. When steady employment at rising wages is offered at home, it is hardly to be expected that workmen will flock to the centers where war industries flourish. Moreover, the abnormally high wages that are offered all too frequently seem to be accompanied by, if not to occasion, a positive loss in efficiency. To sum up, although the total output of industry is now perhaps greater than ever before, the proportion of it which is of military value is far less than is urgently needed, and far less than its possible maximum.

As evidence of the large possibilities of securing additional labor and materials for war purposes, a few concrete examples of conditions in particular industries and occupations will perhaps be helpful. Consider first the case of the pleasure automobile. There has been little if any diminution of the consumption of gasoline, and

very few chauffeurs have been dispensed with. Chauffeurs as a class have mechanical instincts and many possess not a little mechanical skill. All of them could be usefully employed in connection with our shipbuilding program or in allied occupations. This is not a question to be determined by the ability of the employer to pay the wages of the chauffeur. The country needs the discontinuance of such use of this part of its limited supply of labor. In any event it will be discontinued in the course of time. Far more progress would already have been made in this direction if the War Revenue Act recently passed by Congress had included a tax of \$10 a month rising by stages to \$50 a month after next March on all employers of chauffeurs for other than commercial or professional purposes. A heavy tax on gasoline used in running pleasure cars would also be serviceable here and at the same time effect a desirable economy among those who drive their own cars.

Turning next to the sugar industry we find that manufacturers of candy and soda fountain syrups have been running full blast all summer, while economy in the household use of sugar has been urged and in some measure practiced. Subjected recently to temporary curtailment of production and threatened by the necessity of closing down permanently, manufacturers have protested on the ground that thousands would be thrown out of work—this at a time when even were sugar as plentiful as sand, it may well be doubted whether these businesses should continue at the pre-war level of production. A heavy tax on candy and syrups would have conserved the supply of sugar and might also have led to a gradual contraction in production, rather than the sudden cessation of operations which now threatens. In this instance, the loan policy cannot even be credited with bringing about that gradual transfer from a peace to a war footing which is so desirable when it does not interfere with military preparations.

Consider next the wool situation. Apparently the government will require practically all the available supply, yet having civilian orders on hand, the mills have not yet begun to curtail operations. Curtailment of production will apparently come in a series of jolts and perhaps with a crash. Had very much heavier income taxes been imposed the civilian demand for cloth would have been materially restricted. Mills would probably have gradually curtailed the scale of their operations relieving the labor market in some measure and conserving the supply of wool.

Finally consider the case of coal. Production is on a greater scale than ever before, yet the supply is inadequate and its movement taxes our transportation facilities. Price fixation is a further complication. The situation is so intolerable that the Priority Board will probably be forced to take drastic action limiting or cutting off altogether consumption in industries which are valueless for military purposes. By this method it will accomplish something which might have been brought about in a far more gradual fashion by taxation which would have placed a check upon individual consumption, and consequently the demand for coal in civilian industries.

When subjected to the test of contributing to a maximum of military preparation in the shortest possible time, the revenue measure recently passed by Congress leaves much to be desired. In making this statement it is proper to add that it should not be taken as a criticism of the patriotic and generally speaking wise work of the members of the committees which framed the measure. The possibilities of taxation as a means of hastening effective military preparation have never, so far as I am aware, been given thorough-going consideration. Another war revenue measure must, however, be framed in the near future, and so it will perhaps be worth while to consider with this object in view some of the modifications which may well be made in the present law.

The very heavy rates of taxation imposed upon large incomes are entirely proper upon purely financial grounds; they have, however, little or no significance with regard to military preparation, since the money taken by the tax gatherer from such persons would in almost every instance have been invested, most of it no doubt in liberty bonds. The more moderate rates on incomes of less than say \$100,000 are quite as likely to occasion a reduction in the accustomed amount of savings as in consumption. A tax of twenty-five per cent, as in England, on entire incomes of \$12,500 with suitable super-taxes on income in excess of that amount would be financially desirable and might also be expected to bring about not a little curtailment in the consumption of goods by individuals. But income taxes alone would not accomplish the end in view. The expense and administrative difficulties of the tax forbid its application to the great mass of people. They, and in fact the entire community, can be reached by taxes on consumption, and it is consump-

tion that must in some way be checked either by the unsatisfactory method of rising prices alone, or by a combination of rising prices and of taxation. Every commodity or service in connection with which much labor and material valuable for military purposes are employed would be a proper subject for taxation at the present time. We as a people are in the situation of an athletic team training for a contest. But there are so many of us that we lack the compelling unifying influence which is present in a small group working for a common purpose. Through taxation we can gain this unifying influence. It is, for example, not difficult to convince most men that their chauffeurs might be more usefully employed, but for any one individual to act in the matter would obviously amount to so little that he ordinarily does nothing. Let virtually everyone dispense with chauffeurs and the value of the proceeding as a whole would lighten the feeling of deprivation to each individual. Again, in the case of sugar we might tax all sugar, or since a part of it is a necessary food, we might tax only the articles of luxury in the production of which it is an important constituent. A tax of twenty-five per cent or even fifty per cent on the retail price of candy would conserve sugar by bringing about a reduction in one of its relatively unimportant uses.

Many other commodities and services should also be taxed, but these instances will sufficiently illustrate the two advantages which may be gained. In some cases, a tax on tea for example, revenue would be the primary object, in others, as the tax on chauffeurs, the setting free of labor or conserving materials for war uses.

Of course the burden of heavy consumption taxes would fall unequally upon different people and classes. The same statement may be made regarding the effects of the rapid rise of prices occasioned when wars are financed by loans. It may, however, be urged that people endure the burden which comes upon them from rising prices very much in the same resigned fashion that they accept the infirmities of old age, while analogous burdens due to specific taxes might occasion serious discontent. I should feel inclined to agree, but at the same time I should add that I feel even more certain that if the people are convinced that heavy consumption taxes would contribute to preparation for the war and hasten its speedy conclusion, they would not flinch from the burden.